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No. 913

In the Supreme Court of the United States

OCTOBER TERM, 1941

AMERICAN CHICLE COMPANY, PETITIONER

v.

THE UNITED STATES

ON WRIT OF CERTIORARI TO THE COURT OF CLAIMS

BRIEF FOR THE UNITED STATES

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OPINION BELOW

The opinion of the court below (R. 18-24) is reported in 41 F. Supp. 537.

JURISDICTION

The judgment of the Court of Claims was entered November 3, 1941 (R. 25). The petition for a writ of certiorari was filed January 30, 1942, and was granted March 9, 1942. The jurisdiction of this Court is conferred by Section 3 (b) of the Act of February 13, 1925, as amended by the Act of May 22, 1939.

QUESTION PRESENTED

Section 131 (f) of the Revenue Acts of 1936 and 1938 allows a credit to domestic corporations which receive dividends from foreign subsidiaries. The credit is equal to a specified proportion of the foreign income, war-profits and excess-profits taxes

paid by foreign subsidiaries "upon or with respect to the accumulated profits" from which the dividend was paid. Section 131 (f) also defines the accumulated profits to be the total "gains, profits, or income in excess of the income, war-profits, and excess-profits taxes imposed upon or with respect to such profits or income." The question is whether the Commissioner correctly computed the credit allowable to petitioner by applying the specified proportion to only that part of the total foreign taxes which was attributable to the accumulated profits.

STATUTES AND REGULATIONS INVOLVED

The statutes and regulations involved are set forth in Appendix A, *infra*, pp. 38-45.

STATEMENT

The facts were stipulated and found by the court as stipulated (R. 14-24). They may be summarized as follows:

Petitioner is a corporation which, during the taxable years 1936, 1937, and 1938, received dividends from one or more foreign corporations of which it was the sole stockholder. The subsidiaries paid taxes upon their earnings to the foreign countries in which they were domiciled (R. 15). In its income-tax returns for each of these years, petitioner claimed the benefit of the credit allowed by Section 131 (f) of the Revenue Acts of 1936 and 1938 for foreign taxes paid (R. 14). Petitioner paid the income taxes shown on its returns for each of these years and additional assessments deter-

mined by the Commissioner of Internal Revenue for each of the years (R. 14-15).

In computing the credit to petitioner for foreign taxes paid by its foreign subsidiaries under Section 131 (f) the Commissioner of Internal Revenue used this basic formula: he took the total profits of the subsidiary before the foreign income, war-profits and excess-profits taxes were deducted, and subtracted the amount of such taxes, thus obtaining an amount which Section 131 (f) defines as "accumulated profits." Second, he took the proportion of the total foreign taxes which the accumulated profits bore to the total profits, thus obtaining what he conceived to be the foreign taxes paid "upon or with respect to the accumulated profits." Third, the Commissioner took the ratio of the dividends received to the accumulated profits and applied it to the amount which he had obtained by the second step as the taxes paid "upon or with respect to the accumulated profits," thus obtaining the credit (R. 16).¹

Subsequently, petitioner filed claims for refund on the ground that the Commissioner's computation was erroneous and that it was entitled to a larger credit (R. 17-18). Following the rejection of the claims, petitioner commenced these suits for

¹ In the actual mathematical computation, the second and third steps may be run together and the equation expressed (R. 15):

$$\frac{\text{Total foreign taxes paid}}{\text{Total profits}} \times \frac{\text{Accumulated profits}}{\text{Accumulated profits}} \times \frac{\text{Dividends received}}{\text{Accumulated profits}} = \text{Credit}$$

In using these shorthand expressions, care must be taken to

refunds (R. 1, 7).² Petitioner urged that in a correct computation, the second step taken by the Commissioner would have been omitted so that the ratio of dividends to accumulated profits would have been applied to the total foreign taxes paid upon or with respect to the total profits, the latter taxes being, in petitioner's view, the taxes paid "upon or with respect to the accumulated profits."³

The Court of Claims held that the Commissioner had computed the foreign tax credit correctly and dismissed the petitions.

preserve the same meaning. Thus, in the above formula, the phrases have the following meanings:

Total foreign taxes = Foreign income, war-profits and paid excess-profits taxes paid upon or with respect to the total profits.

Total profits = Total profits for year in which were accumulated the profits from which the dividends were paid.

Accumulated profits = Accumulated profits from which the dividends were paid, as defined by Section 131 (f).

When we use the convenient shorthand expressions, we shall use them with the above meanings.

² Two petitions were filed in the Court of Claims involving refund of identical taxes. In the first suit a part of the taxes sought to be refunded was paid subsequent to the filing of the refund claims upon which the suit was based. Later, additional refund claims were filed and the second suit instituted after the rejection thereof.

³ Petitioner expresses its equation as follows (R. 15):

$$\text{Foreign tax paid} \times \frac{\text{Dividends received}}{\text{Accumulated profits}} = \text{Credit}$$

SUMMARY OF ARGUMENT

Section 131 (f) limits the foreign tax credit to a specified proportion of foreign "income, war-profits and excess-profits *taxes paid* * * * *upon or with respect to the accumulated profits.*" In the next sentence it defines accumulated profits as the gains, profits, or income in excess of the foreign "income, war-profits, and excess-profits *taxes imposed upon or with respect to such total profits or income.*" These sharply contrasting phrases must have been used to describe different amounts of taxes. The latter phrase admittedly refers to the total foreign taxes paid upon the total profits. Petitioner would give the same meaning to the former phrase. But the contrast shows that it refers to something less than the total foreign taxes, for the accumulated profits are less than the total profits. It describes the portion of the total foreign taxes which is attributable to the accumulated profits, *i. e.*, the proportion of the total foreign taxes which the accumulated profits bear to the total profits. This interpretation has been reflected in Treasury practice since 1931; it was formally incorporated in Regulation 77 under the Revenue Act of 1932 and has remained in all subsequent editions.

This interpretation carries out the purpose of Section 131 (f). The credit is allowed to avoid double taxation of the same earnings; Congress believed that the profits and income of a subsidiary corporation which were taxed abroad, should not

be taxed again as dividends when they were received by the parent corporation. One reason for the use of the term "accumulated profits" was to describe the greatest part of the subsidiary's earnings which would ever be taxed as dividends in the United States; the other part of the total profits, *i. e.*, the foreign taxes upon such profits, would never be available for distribution and never be taxed in the United States. For this reason, the maximum credit which the United States had any reason to allow was the portion of the foreign taxes attributable to the accumulated profits; which portion is, in the words of the statute, the "taxes paid * * * upon or with respect to the accumulated profits." And, since the maximum amount available for dividends might never be distributed, the statute goes on to specify that the actual credit shall be only the proportion of the potential credit which the dividends actually received and taxed bear to the potential dividends, *i. e.*, the accumulated profits.

Petitioner's interpretation disregards this logic of the statute and by fixing the maximum credit at the total foreign taxes seeks a larger credit than is necessary to avoid double taxation. In this way, petitioner would secure a discriminatory advantage for the domestic holding company and foreign subsidiary as against the single enterprise with foreign branches. Thus, under petitioner's theory, in the case of a foreign subsidiary with earnings of

\$200,000 which had paid foreign taxes of \$20,000, and had distributed the remaining \$180,000 to its parent, the parent would include the \$180,000 in its taxable income and would claim a credit of \$20,000. In the case of the domestic corporation doing business abroad through an unincorporated branch, the credit, it is true, would be \$20,000, but the domestic corporation would have to include the entire \$200,000 in its gross income in order to compute the domestic taxes against which the credit applies. The vice in petitioner's computation is that it would offset foreign taxes based upon \$200,000 against domestic taxes based upon \$180,000. The Government's method of computation takes into account the fact that the domestic corporation already receives a tax advantage by including the smaller amount in its gross income, and shrinks the credit proportionately so as to make the amounts commensurate. The statute was scientifically constructed so as to achieve this result, and had Congress intended any other result with attendant discriminatory advantage for the domestic corporation with foreign subsidiaries, it would have expressed it.

The Commissioner's interpretation also gives full effect to the changes made at the time Section 131 (f) took its present form in the Revenue Act of 1921. The Revenue Act of 1918 had prevented double taxation without allowing an overcredit, in the case of dividends from the earnings of the pre-

vious year. It had failed to make provision for the earnings which paid foreign taxes but were not distributed as dividends until several years later. To correct this fault the term "accumulated profits" was substituted, and the formula modified accordingly; but there is no reason to suppose that it was intended to enlarge the credit in all cases. The legislative history shows affirmatively that such a change was not intended. Senator Shoot's example, which supports petitioner, was an illustration of a different point than is here at issue. Moreover, it is contrary to the controlling report of the conference committee.

The computations made by the Commissioner were prescribed by the Treasury regulations for all years after 1932, including the years in question. Petitioner argues that the regulation is invalid because from 1921 to 1931 the form used by the Treasury prescribed the computation which petitioner advocates. The power of the Commissioner to change his regulations prospectively is too well settled to merit discussion. Since the present regulation is a reasonable interpretation of Section 131 (f), it is conclusive.

ARGUMENT

I

THE FORMULA USED BY THE COMMISSIONER WAS CORRECT

Introductory.—Section 131 (f) of the Revenue Act of 1936 allows a domestic corporation receiving dividends from a foreign subsidiary a credit for—

the same proportion of any income, war-profits, or excess-profits taxes paid by such foreign corporation to any foreign country

* * * upon or with respect to the accumulated profits of such foreign corporation from which such dividends were paid, which the amount of such dividends bears to the amount of such accumulated profits. * * *

There is no dispute in the present case as to the proportion. "The amount of such dividends" is the amount of dividends received by the domestic corporation from the foreign subsidiary. "The amount of such accumulated profits" refers plainly enough to the accumulated profits from which the dividends were paid and that term is itself defined by Section 131 (f) as "the amount of its [the subsidiary's] gains, profits, or income in excess of the income, war-profits, and excess-profits taxes imposed upon or with respect to such profits or income." The dispute concerns only the amount of foreign taxes to which the specified proportion is to be applied; the dispute is, what is the meaning of the phrase "taxes paid . . . upon or with respect to the accumulated profits."

An example will make this issue concrete. If petitioner's wholly owned subsidiary had had income in 1936 of \$200,000 and had paid a Canadian income tax of ten percent, amounting to \$20,000, its accumulated profits as defined by Section 131 (f) would have been \$180,000 (i. e., the amount of its "gains, profits, or income" in excess of "the income,

war-profits, and excess-profits taxes imposed upon or with respect to such profits or income"). If the Canadian subsidiary had then declared a dividend of \$180,000, petitioner would claim a credit of \$20,000 as the amount of the "taxes paid * * * upon or with respect to the accumulated profits." The Commissioner, on the other hand, would reject the claim on the ground that \$20,000 is the amount of taxes paid "upon or with respect to" the profits or income of \$200,000 and not the amount paid "upon or with respect to the accumulated profits" of \$180,000. He would allow only the tax of ten percent on the accumulated profits, a credit of \$18,000. Thus, the issue in the present case, stated in the concrete terms of our example, is whether the amount of "taxes paid by such foreign corporation * * * upon or with respect to the accumulated profits" is \$20,000, the total tax on the \$200,000 total income, or \$18,000, the portion of the total tax attributable to the \$180,000 accumulated profits.

The command of the statute can be expressed in an equation. Both petitioner and the Commissioner agree that it is:

$$\text{Credit} = \frac{\text{dividends}}{\text{accumulated profits}} \times \text{taxes paid upon or with respect to the accumulated profits.}$$

The dispute concerns the multiplicand. Petitioner would substitute total foreign taxes paid, making the equation:

$$\text{Credit} = \frac{\text{dividends}}{\text{accumulated profits}} \times \text{total foreign taxes paid.}$$

Petitioner actually uses the term "taxes paid" as short-

Since 1933 the applicable Treasury Regulations have interpreted Section 131 (f) to prescribe the calculation made by the Commissioner.

hand for total foreign taxes paid, but this is confusing for it refers equally well both to taxes paid upon or with respect to the total profits or income and to taxes paid upon or with respect to the accumulated profits, a distinction which must be carefully observed in reading the statute. (See note 1, *supra*, p. 4.) The Commissioner would substitute only that portion of the total taxes paid which the accumulated profits bear to the total profits, thus obtaining as the multiplicand the taxes paid which were attributable to the accumulated profits:

$$\text{Credit} = \frac{\text{dividends}}{\text{accumulated profits}} \times \left(\frac{\text{accumulated profits}}{\text{total profits}} \times \text{taxes paid} \right)$$

Let us apply these formulae to our example to make them concrete:

Total profits	-----	\$200,000
Total taxes paid	-----	20,000
Accumulated profits	-----	180,000
Dividends paid	-----	180,000

Petitioner contends that the computation should be:

$$\text{Credit} = \frac{\$180,000}{\$180,000} \times \$20,000$$

$$\text{Credit} = \$20,000$$

The Commissioner would make the computation:

$$\text{Credit} = \frac{\$180,000}{\$180,000} \times \left(\frac{\$180,000}{\$200,000} \times \$20,000 \right)$$

$$\text{Credit} = \frac{\$180,000}{\$180,000} \times \$18,000$$

$$\text{Credit} = \$18,000$$

Thus, the issue is whether \$20,000 or \$18,000 is the taxes "paid * * * upon or with respect to the accumulated profits," and is to be used as the multiplicand.

1. THE COMMISSIONER'S METHOD OF COMPUTING THE CREDIT
FOLLOWS THE PLAIN MEANING OF THE WORDS OF SECTION
131 (f)

The words of Section 131 (f) in plain terms forbid applying the specified proportion to the total foreign taxes paid upon the total profits and income out of which the dividend was paid. They direct that the proportion be applied only to the taxes paid "upon or with respect to the accumulated profits" out of which the dividend was paid. The limitation prescribed is made clear in the very next sentence. It defines the "accumulated profits" as the amount remaining after subtracting from the year's total profits and income the amount of taxes paid "upon or with respect to such profits or income." In the previous sentence, therefore, the very purpose of using the contrasting phrase, "taxes paid * * * upon or with respect to such accumulated profits," to describe the taxes to which the specified proportion is to be applied, must have been to require the proportion to be applied to an amount less than the total foreign taxes, *i. e.*, to that part of the total foreign taxes which is attributable to the accumulated profits. The computations made by the Commissioner achieve that result. In them he assumes that the accumulated profits bear their share of the total foreign taxes and no more; thus he takes as the taxes paid "upon or with respect to the accumulated profits" that part of the total foreign taxes which the accumulated profits bear to the total profits. * In this way, and in this way alone, the

words of section 131 (f) are satisfied and the contrasting expressions are given different meanings.

Petitioner, with the support of two inferior court decisions,⁸ objects to reading Section 131 (f) in this straightforward manner on the ground that the resulting formula may be reduced to an equation in which the accumulated profits are not used. That fact is quite irrelevant. As we shall show in discussing the genesis of Section 131 (f), the familiar term "accumulated profits" was used to allow a credit, not just for taxes paid on current profits distributed as dividends, but also for taxes paid on profits earned in one year and distributed as dividends in a later year. That a more cumbersome and less familiar phrase could have been used to accomplish that purpose is not a reason for disregarding the plain language used.⁹

⁸ See *International Milling Co. v. United States*, 89 C. Cls. 128, 136; *Aluminum Co. of America v. United States*, 123 F. (2d) 615 (C. C. A. 3). See also *F. W. Woolworth Co. v. United States*, 91 F. (2d) 973 (C. C. A. 2), certiorari denied, 302 U. S. 768. The Court of Claims in effect repudiated its decision in the *International Milling* case in its opinion in the instant case.

⁹ Petitioner's argument on this point is expressed in equations. Thus, he says that the Commissioner uses the following equation:

$$\text{Credit} = \frac{\text{dividends received}}{\text{accumulated profits}} \times \left(\frac{\text{accumulated profits}}{\text{total profits}} \times \frac{\text{total foreign taxes}}{\text{taxes}} \right)$$

Petitioner then points out that this equation reduces to

$$\text{Credit} = \frac{\text{dividends received}}{\text{total profits}} \times \text{total foreign taxes}$$

And, finally, it is suggested that if Congress had in mind

We need not embark with petitioner upon a study of the niceties of the distinction between the words "upon" and "with respect to," nor need we delay to point out that in Section 240 (c) of the Revenue Act of 1918, from which Section 131 (f) is derived, Congress spoke of income, war-profits, and excess-profits taxes paid "upon or with respect to" total taxable income, a usage which disregards the distinction that petitioner would draw. In drafting a general statute applicable to foreign corporations in countries having differing concepts

this simple formula, it would have used it instead of speaking of and carefully defining "accumulated profits."

But the simplicity of the formula is deceptive, as is shown by the lower court decisions. "Total profits" as it appears in these formulae is a shorthand expression for the total gains, profits, and income of any year before the deduction of income, war-profits, and excess-profits taxes. As applied to any current year, the complete expression might perhaps have been used. But Section 131 (f) was also intended to allow a credit where dividends earned in one year were distributed years later. Such dividends are not paid out of total profits but out of accumulated profits. Consequently, when the shorthand "total profits" is used in the formula as applied to a prior year, it stands for the total gains, profits, and income of the year out of the accumulated profits of which the dividend was declared. All this, so conveniently expressed in shorthand in the formulae, would have to be carefully spelled out in a statutory provision as part of the proportion and again as part of the description of the tax to which the proportion should be applied. And when that was done, Congress would still have to define accumulated profits and prescribe how the Commissioner should determine from what accumulated profits the dividend was declared. Manifestly, the course followed by Congress was simpler and clearer.

of taxable income, Congress was entitled to take account of the facts, first, that the total foreign income, war-profits, and excess-profits taxes are in a substantial sense paid upon or with respect to total gains, profits, or income; and, second, that the taxes paid upon or with respect to the accumulated profits are, in every substantial sense, that proportion of the total taxes which the accumulated profits are of the total gains, profits, or income. Recognizing this, neither the petitioner nor the Commissioner has had any doubt that the taxes described by the statute as foreign income, war-profits, and excess-profits taxes imposed "upon or with respect to" the subsidiary's gains, profits, or income are the total foreign income, war-profits, and excess-profits taxes; they calculated the accumulated profits of each subsidiary upon that very basis (R. 16, 17). And if that is true, as both the petitioner and the Commissioner agree, those very same taxes cannot be the taxes described by the statute as "taxes paid * * * upon or with respect to the accumulated profits." Petitioner's argument, therefore, does not avoid this fundamental objection to its entire theory—that its construction necessarily gives two different phrases in the same section a single meaning.

2. THE COMMISSIONER'S INTERPRETATION CARRIES OUT THE PURPOSE OF SECTION 131 (f)

The importance of the contrasting phrases "taxes * * * upon or with respect to such

[total] profits or income" and "taxes upon or with respect to the accumulated profits" lies in the substantial purpose of the foreign tax credit. Domestic corporations doing business abroad often must pay foreign income, war-profits, and excess-profits taxes on their income derived from sources in such foreign countries. The Revenue Acts require this same income to be included in domestic tax returns. Were this all that the Revenue Acts provided, the foreign income would be taxed twice. But Congress believed such double taxation to be unwise and, accordingly, in Section 131 (a) allowed the domestic corporations a credit, up to specified limits, against the United States taxes for the amount of the foreign taxes incurred.¹ See *Burnet v. Chicago Portrait Co.*, 285 U. S. 1. Thus, a domestic corporation which earned \$200,000 at a Canadian branch and paid a ten percent Canadian tax amounting to \$20,000, would return \$200,000 for United States taxes and would receive a credit of \$20,000 against the resulting tax.

¹ In one sense double taxation is not avoided, for the same income is returned for purposes of taxation in two countries. In a substantial sense, however, it is avoided for the corporation pays the same amount of taxes to the two countries as it would if the amount of income returned in both countries had been returned only in the country with the higher tax rate. For example, if a branch of a domestic corporation earned \$200,000 in Canada and the tax rate were 10%, it would pay \$20,000 taxes. If the United States rate were 20%, the corporation would return the \$200,000 together with its other income and pay on the

In the case of a domestic corporation doing business abroad through a foreign subsidiary the case is much the same. The subsidiary pays foreign income, war-profits, and excess-profits taxes upon its income, hence any dividends distributed to the domestic parent will come from current or accumulated income which has already been subjected to foreign income, excess-profits, and war-profits taxes. These dividends, which must be returned by the domestic corporation for tax purposes, would be subjected to double taxation if no further provision had been made. Section 131 (f), however, makes such provision. Its purpose, like the purpose of Section 131 (a) for domestic corporations doing business abroad through foreign branches, is to avoid that double taxation. *Burnet v. Chicago Portrait Co., supra.* But there is this difference. The parent of the foreign subsidiary returns for United States taxes, not the total Canadian income as does the corporation with Canadian branches, but only the Canadian income less the Canadian taxes, *i. e.*, the dividends declared. And since only the dividends are taxed in the United States, the amount of the credit to be allowed to avoid double taxation would be the amount of the total foreign

branch income taxes amounting to \$40,000 less the credit of \$20,000, or \$20,000. Thus, the total paid to both countries would be \$40,000, just as if the entire business were domestic. If the Canadian rate were higher than the United States rate, the credit would equal the United States taxes upon the branch income, with the result that it would be taxed only in Canada. See note 8, *infra* p. 18.

taxes which the dividends might fairly be said to have incurred. In our supposed case, for example, petitioner's Canadian subsidiary had total profits of \$200,000 and distributed a dividend of \$180,000 to petitioner, after paying Canadian income, war-profits, and excess-profits taxes amounting to \$20,000 at the rate of 10 percent. In such a case, only \$180,000 would be returned for tax purposes in the United States and to avoid double taxation the United States would need to allow a credit not for the total Canadian taxes but only for the Canadian taxes attributable to that sum of \$180,000, *i. e.*, \$18,000. Petitioner's construction, which would allow a credit for the total Canadian taxes of \$20,000, would result in an overcredit of \$2,000, in the sense that the credit would be \$2,000 larger than the purpose requires.* Moreover, petitioner's interpretation discriminates against the branch business which must return the entire \$200,000 for United States taxes and yet receives only exactly the same \$20,000 credit as petitioner claims against the United States taxes on \$180,000.

The purpose to avoid double taxation but prevent any overcredit and resulting discrimination against

* It is argued by petitioner (Br. 26-28) that any "over-credit" is prevented by a proviso to section 131 (f) which provides:—

That the amount of tax deemed to have been paid [*i. e.* for which the credit is allowed] under this subsection shall in no case exceed the same proportion of the tax against which credit is taken which the amount of such dividends bears to

branch businesses is a key to Section 131 (f). A foreign subsidiary never has available to distribute as a taxable dividend more than its total profits and income, whenever earned, less the foreign "income, war-profits and excess-profits taxes imposed

the amount of the entire net income of the domestic corporation in which such dividends are included."

Petitioner is using overcredit with different meaning than that in which we, and the court below, have used it. The purpose of the proviso is to prevent the credit from exceeding the United States tax on the dividends. For illustration, suppose that in our assumed case the parent received income from sources wholly within the United States of \$360,000. It would return \$540,000. If the United States tax rate were 5%, the taxes would be \$27,000. Were it not for the proviso, the parent would be allowed a credit of \$18,000, on the Commissioner's construction, or \$20,000, on the petitioner's; thus, the taxes paid to the United States would be \$9,000 or \$7,000. This would be less than the amount paid if the dividends had not been returned and no credit allowed. (5% tax \times \$360,000 domestic income = \$18,000.) This diminution of United States taxes where the foreign tax rate exceeded the United States tax rate was possible under Section 240 (c) of the Revenue Act of 1918. See p. 31, *infra*. The proviso to Section 131 (f), which became law first in the Revenue Act of 1921, stopped the practice. Its effect under the above conditions is to limit the credit as follows:

$$\text{Limit on Credit} = \frac{\$180,000}{\$540,000} \times \$27,000 = \$9,000$$

The United States taxes paid would be \$18,000. Thus, the effect of the proviso is to prevent diminution of the United States taxes. Upon the foregoing facts the issue involved in the instant case would be immaterial. But if the United States tax rate were higher than the foreign tax rate, the proviso would have no application. Assume that the United States rate were 20% and the other amounts the same. United States tax = 20% of (\$360,000 + \$180,000) = \$108,000. The Commissioner would allow a credit of \$18,000 and peti-

on such profits or income." This part of the total profits and income is defined by Section 131 (f) as the "accumulated profits"; more than this part will never be taxed in the United States. Consequently, when Section 131 (f) allows the credit for a specified portion of the "income, war-profits, or excess-profits taxes paid" * * * upon or with respect to the accumulated profits," it quite properly limits the maximum allowable credit to so much of the total foreign income, war-profits, and excess-profits taxes as the subsidiary paid upon the only part of the total profits which will ever be taxed in the United States. For example, in our supposed case \$180,000 is the greatest sum which will be taxed in the United States and \$18,000 is the greatest credit which can ever be secured.*

petitioner would claim a credit of \$20,000. The proviso does not accomplish any limitation:

$$\text{Limit on Credit} = \frac{\$180,000}{\$540,000} \times \$108,000 = \$36,000$$

On petitioner's theory there would be, therefore, an over-credit in the sense pointed out in the text, *i.e.*, a credit larger than the credit necessary to prevent double taxation.

The fact that petitioner is engaged in this litigation is also complete proof that its formula would allow an over-credit. It is not denied that the computation made by the Commissioner allows all the credit necessary to prevent double taxation. Petitioner's formula would result in a larger credit; that is why it brought these suits. Hence petitioner's formula must result in an overcredit.

* The calculation is:

$$\text{Maximum Credit} = \frac{\$180,000}{\$200,000} \times \$20,000$$

The actual credit due at any one time, however, may be smaller for all the accumulated profits may not be declared as dividends to the parent and taxed to it in the United States; some might be retained or the parent might not own one hundred percent of the stock. Section 131 (f) covers this second problem by allowing the credit only for that part of the maximum credit—the "taxes paid * * * upon or with respect to the accumulated profits"—which the dividends received bear to the accumulated profits. Thus, in the supposed case \$180,000 could be subjected to both domestic and foreign taxes because all of it was declared as a dividend. The proportion would be \$180,000 dividends to \$180,000 accumulated profits so that a credit equal to the \$18,000 taxes upon the accumulated profits of \$180,000 would be allowed. But if only \$90,000 had been received as dividends by the parent only \$90,000 would be subject to tax in both countries at that time; the proportion then would be \$90,000 dividends to \$180,000 accumulated profits and a credit of only \$9,000 would be allowed; the credit for the tax on the remaining \$90,000 would not be allowed until it was distributed.

Thus, by first fixing the maximum credit at the foreign taxes upon the profits and income which are potential dividends (the "taxes * * * upon or with respect to the accumulated profits") and by then limiting the actual credit to the proportion of the maximum credit which the dividends actually

received bear to the potential dividends, Section 131 (f) achieves precisely the amount of credit necessary to prevent double taxation of the dividends received.

Before leaving the purpose of Section 131 (f), it is important to compare it again with the parallel section, Section 131 (a). Section 131 (a) deals with domestic corporations doing business abroad through foreign branches. Section 131 (b) deals with domestic corporations doing business abroad through foreign subsidiary corporations. Both have a single purpose—to avoid double taxation. Hence, it is reasonable to suppose, as the court below concluded (R. 22), that Congress did not intend by these provisions to grant an advantage to either type of business organization. A domestic corporation doing business abroad in a country imposing a ten percent tax would pay taxes of \$20,000 upon branch earnings of \$200,000 and would return \$200,000 for purposes of United States taxes. Under Section 131 (a) it would be allowed a credit of \$20,000. But if another domestic corporation did the same volume of business abroad through a subsidiary which also earned \$200,000 and if the subsidiary paid the same taxes of \$20,000, the domestic corporation would return only \$180,000 as dividends. Thus, the branch business returns a larger sum than the parent and subsidiary for United States taxes. Under such circumstances, to allow the parent the same credit of \$20,000 as the

single corporation with a foreign branch, as petitioner contends should be done, would discriminate seriously in favor of the parent and subsidiary against the single corporation. On the other hand, under the Commissioner's interpretation the credit of the parent would be \$18,000 and Sections 131 (a) and (f) would achieve approximate equality.¹⁰

¹⁰ Testifying on Section 238 (e), of the Revenue Act of 1921, which was identical with Section 131 (f), Dr. Adams, its draughtsman, explained that the case of an American corporation doing business abroad through a foreign subsidiary was "economically and practically" much the same situation as a business with foreign branches. He said (Hearings before the Committee on Finance, United States Senate, 67th Cong., 1st Sess., on H. R. 8245, p. 389):

"The proposal is to give this American corporation about the same credit as if conducting a branch, and the situation is this—"

The credit given to the branch business would be precisely the same, on the Commissioner's interpretation, as that given to the parent and subsidiary, whenever the foreign rate was equal to or higher than the United States tax rate. In the example in the text, if the United States rate was 10 percent like the Canadian rate, the branch business would offset the credit of \$20,000 against the United States tax of \$20,000 upon the \$200,000 earnings. And, the foreign corporation would offset the credit of \$18,000 against the United States tax of \$18,000 on the dividends of \$180,000. If the Canadian tax rate were higher than the United States tax rate the credits would more than offset the United States taxes upon the earnings or dividends, but there would be equality, for provisos to Sections 131 (a) and (f) forbid allowing a greater foreign tax credit than the amount of the United States taxes attributable to the foreign earnings or dividends. See note 8, p. 18, *supra*. But if the United States tax rate were higher than the Canadian rate, then the corporation would have an advan-

Petitioner attempts to answer this consideration by pointing out that sometimes other factors may give a relative advantage to branches as against subsidiaries, and that on other occasions the contrary may be true (Br. 28-29). It gives the example of a domestic corporation which gains an advantage because it may deduct a loss on the sale of Canadian land in making United States returns whereas a subsidiary could not take the deduction under Canadian law in making Canadian returns (Br. 30-31). The arguments miss the point. We do not suggest that Section 131 (a) and (f) are intended to equalize the positions of the two different types of enterprises; their relative advantages depend on many provisions of domestic and foreign law, including other sections of the Revenue Act. We urge simply that it is improper to construe these provisions, aimed only at avoiding double taxation, to discriminate in favor of the corporate parent and subsidiary and against the single corporation by allowing the parent an overcredit and thus altering whatever the relative advantages

of the branch. Thus, assume that in the example the United States tax rate was twenty percent. The branch business would be taxed twenty percent of \$200,000, or \$40,000, and have a credit of \$20,000. The parent corporation would pay twenty percent of \$180,000, or \$36,000, and have a credit of \$18,000 for the subsidiary's taxes. It must have been these facts that led Dr. Adams to say, in substance, that he sought equality and would allow "about the same credit."

might otherwise have been. Had Congress had such a purpose, it would have been expressed.

3. THE LEGISLATIVE HISTORY OF SECTION 131 (f) SUPPORTS THE COMMISSIONER'S INTERPRETATION

We have pointed out above the contrasting expressions in Section 131 (f)—“taxes paid * * * upon or with respect to the accumulated profits,” on the one hand, and “taxes imposed upon or with respect to such [total] profits or income” on the other—a contrast which petitioner would ignore. We have shown that one key to this language is the purpose of Congress to avoid double taxation without allowing the overcredit and resulting discrimination in favor of corporate subsidiaries which petitioner seeks to secure. A second key is the legislative history in general, but particularly the changes wrought when Section 131 (f) was cast in its present form as Section 238 (e) of the Revenue Act of 1921.

Section 240 (e) of the Revenue Act of 1918, c. 18, 40 Stat. 1057, 1082, allowed a domestic corporation receiving dividends from a foreign subsidiary a credit for:

* * * the same proportion of any income, war-profits and excess-profits taxes paid (but not including taxes accrued) by such foreign corporation during the taxable year to any foreign country * * * which the amount of any dividends (not deductible under section 234) received by such

domestic corporation from such foreign corporation during the taxable year bears to the total taxable income of such foreign corporation upon or with respect to which such taxes were paid * * *.

This section achieved the purpose of avoiding double taxation upon amounts taxed as dividends by the United States if the foreign corporation earned profits in one year, and paid foreign taxes and distributed a dividend from those profits in the year following.¹¹ Thus, in the case of the foreign subsidiary which earned \$200,000, paid a ten percent tax amounting to \$20,000, and distributed \$180,000 to its parent as a dividend, Section 240 (c) would permit a credit of \$18,000. Provided that all the profits were divided and all the foreign taxes upon them were paid in the taxable year, then the formula of the 1918 Act is not substantially different than the formula which the Commissioner now applies.

But Section 240 (c) of the Revenue Act of 1918 did not prevent double taxation in cases where profits earned by the foreign subsidiary were distributed in a different year than that in which the taxes upon them were paid. To illustrate, if a

¹¹ It is safe to assume that foreign taxes paid in the taxable year were paid on profits earned by the foreign corporation in the year immediately preceding. But that is not necessarily true for the fiscal year of the parent and subsidiary could differ. To deal with such a case would simply complicate a problem which is confusing at best without changing anything of substance.

subsidiary which earned \$200,000 of taxable income and in the next year paid a \$20,000 tax, distributed only \$90,000 to the parent, a credit of \$9,000 would be allowed. That would be in accordance with the purpose to avoid double taxation for only \$90,000 would be subjected to both foreign and domestic taxes. However, if the second \$90,000 was distributed alone in some later year in which no foreign taxes were paid because of a lack of earnings, no credit would be allowed and the second \$90,000 would be subjected to double taxation.

The above example is but one illustration of the curious inequities which Section 240 (c) permitted. Others worked to the taxpayer's advantage. We have given illustrations in Appendix B, *infra*, pp. 46-52. The point to be emphasized, however, is that the difficulties arose because the credit had no necessary relation to the foreign taxes fairly attributable to the dividend; and this relationship was absent because the formula took as the starting point the subsidiary's foreign tax payments in the parent's taxable year and not the taxes upon the source of the dividend.

Evidently it was decided to correct this fault in the foreign tax credit provisions of the Revenue Act of 1921. The task before the draughtsman was to describe the earnings of the foreign corporation, past and ~~current~~, which were a potential source of dividends, and then to allow a credit for the taxes which the distributed portion of those earnings had.

borne. The ordinary accounting phrase which would cover earnings of prior years as well as current earnings, and describe the source of a dividend, was "accumulated profits." The draughtsman appreciated this. He took the phrase "accumulated profits" and substituted it for current taxable income wherever the latter was referred to in Section 240 (c). In the new section, he allowed the credit for a specified proportion of the "taxes paid * * * upon or with respect to the accumulated profits * * * from which such dividends were paid." He specified the new proportion as the ratio of dividends to accumulated profits, thus limiting the credit to the taxes upon the earnings actually distributed. See pp. 21-22, *supra*. This use of the familiar expression "accumulated profits" was the simple and natural way for the draughtsman to prevent both the double taxation and the abuses which had been faults under Section 240 (c) of the Revenue Act of 1918.

This change in the foreign tax credit provision appears to have been unduly minimized by the courts which have held the Commissioner's method of computation erroneous on the ground that it gives no effect to the changed language in the Revenue Act of 1921. See *International Milling Co. v. United States*, 89 C. Cls. 128, 137-138; *Aluminum Co. of America v. United States*, 123 F. (2d) 615, 618-620 (C. C. A. 3). The Commissioner's interpretation gives precise effect to the substitution of "accumulated profits" in the revised provision.

Under the Revenue Act of 1918, he allowed the credit only for the proportion of foreign taxes paid by the subsidiary in the current taxable year which the dividend received by the parent bore to the subsidiary's total taxable income. Under the later acts, he allows the credit for any taxes to which the dividend received, from either past or current profits, may fairly be said to have been subjected.¹² The fact that other more complicated phrases could have been devised to accomplish the change is no reason for doubting this simple ex-

¹² Because of the confusion which appears in the *International Milling* and *Aluminum* cases, we have analyzed at length in Appendix B, *infra*, pp. 46-52, the differences between the computations prescribed by section 131 (f) and by section 240 (c) of the Revenue Act of 1918. The differences appear sharply, however, if the formulae are expressed in equations using, not the convenient but misleading shorthand expressions, but the complete terms. The equation now used by the Commissioner is:

$$\text{Credit} = \frac{\text{Dividends received}}{\text{Accumulated profits out of which the dividends were paid}} \times \frac{\text{Accumulated profits out of which the dividends were paid}}{\text{Total profits of the year in which were accumulated the accumulated profits out of which the dividend was paid}} \times \frac{\text{Foreign taxes upon such total profits}}{\text{Foreign taxes upon such total profits}}$$

○ This reduces to:

$$\text{Credit} = \frac{\text{Dividends received}}{\text{Total profits of the year in which were accumulated the accumulated profits out of which the dividends were paid}} \times \frac{\text{Foreign taxes upon such total profits}}{\text{Foreign taxes upon such total profits}}$$

planation of the choice of words. Giving the words their natural meaning, the change is plainly adapted to curing the fault in the earlier Act, allows all credits necessary to avoid double taxation, and prevents any overcredit and resulting discrimination in favor of subsidiary corporations. There is no reason to torture the words to create additional differences.

The equation prescribed by the Revenue Act of 1918 was:

$$\text{Credit} = \frac{\text{Dividends received}}{\text{Taxable income upon which foreign taxes were paid in current taxable year}} \times \frac{\text{Foreign taxes paid in current taxable year}}{\text{Total foreign taxes paid in current taxable year}}$$

Even if we substituted as rough equivalents, "total current profits" for "taxable income" and "total foreign taxes paid" for foreign taxes paid in current taxable year, the formula would still be very different from that which the Commissioner uses. It would be:

$$\text{Credit} = \frac{\text{Dividends received}}{\text{Total current profits}} \times \text{Total foreign taxes paid}$$

Thus, the Commissioner's formula and the 1918 Act result in the same equation only if the year in which the events occurred is disregarded.

This last formula indicates how the provisions of Section 131 (f) probably developed. Starting with it, the draughtsman abandoned the limitation of "total current profits" and substituted "accumulated profits," obtaining the equation:

$$\text{Credit} = \frac{\text{Dividends received}}{\text{Accumulated profits}} \times \text{Total foreign taxes paid}$$

But this change alone threw the equation out of balance and allowed the overcredit by applying the ratio to unrelated taxes paid on total profits. Therefore, he also substituted taxes "paid * * * upon or with respect to the accumulated profits."

The available legislative materials support this interpretation. The House bill exempted dividends from taxation, hence the foreign tax credit was omitted from the bill. The Senate bill subjected the dividends to tax. Dr. Adams, the Treasury expert, testified before the Senate Committee with regard to the credit (Hearings before the Committee on Finance, United States Senate, 67th Cong., 1st Sess., on H. R. 8245, p. 389):

I rewrote the old provision, safeguarding it from some abuses which it was open to and closing up some of the gaps that were in the old provision.

The abuses to which he referred were the diminution of United States taxes by taking a foreign tax credit in excess of the United States tax on the dividends received.¹³ He did not specify the gaps but it is reasonable to suppose that he had in mind his correction of the fault in Section 240 (c), which had subjected profits accumulated in one year and distributed later to double taxation, and which otherwise failed to relate the credit to the taxes

¹³ If the foreign tax rates were higher than the United States rate, the credit would exceed the United States taxes attributable to the dividends and under Section 240 (c) could be set off against the taxes attributable to income coming from sources wholly within the United States. The only limit fixed by Section 240 (c) was that the credit should not exceed the dividend. In the Revenue Act of 1921 this abuse was ended by a proviso limiting the credit to the same proportion of the United States taxes as the dividend bore to the total income returned. See note 8, *supra*, p. 18.

paid on the earnings distributed. That correction was the other major change in the provision. Nothing Dr. Adams said suggests that any other substantial changes were intended.

Senator Smoot, who was in charge of the bill, made plain the meaning of the revision. Following his general explanation he was asked by Senator Pomerene (61 Cong. Rec. 7184) :

That is, that it allows credit for the moneys actually received here in the country by the parent company?

Senator Smoot replied (*ibid.*) :

By the parent company, and does not give them credit for all that they make in a foreign country upon their business, but only that portion of it which they send to this country.

The Senator's expressed understanding, therefore, was that the credit was allowable only for the tax attributable to the part of the earnings coming into the United States and not for the tax attributable to the total earnings, part of which would be left abroad to pay the foreign taxes. In our now familiar example this would mean a credit of \$18,000 for taxes on the \$180,000 brought into the country and not a credit of \$20,000 for the taxes on the \$180,000 brought into the country plus the \$20,000 left in Canada. It is true that later Senator Smoot gave an example which supports petitioner's contention, but in giving it he was illustrating only what would happen when part of the earnings were

allowed to accumulate. The close of his prepared statement shows that the radical change in the credit for which petitioner contends, was not intended (*ibid.*):

The amendment here under discussion merely reincorporates this credit * * * with safeguards designed to protect the American tax as above described. In short, the amendment in question is merely an improved version of an existing provision of law.

The Conference Report on the Revenue Act of 1921 explained the meaning of Section 238 (e) (now Section 131 (f)) in ~~un~~mistakable words. H. Rep. 486, 67th Cong., 1st Sess., p. 38. It stated that there was provision "for the credit by a domestic corporation of taxes paid by its subsidiary foreign corporation with respect to the income or profits of the foreign corporation paid as taxable dividends to the domestic corporation." This interpretation, that the credit is to be the foreign taxes attributable to the dividends, is the interpretation for which the Commissioner contends.

4. THE COMMISSIONER'S INTERPRETATION IS IN ACCORDANCE WITH THE APPLICABLE TREASURY REGULATION

In 1930 the Commissioner promulgated "Form 1118," headed "For Taxable Year 1931," which required the foreign tax credit to be computed in the manner in which he computed the credit in the instant case. Under the Revenue Act of 1932 the Treasury promulgated Regulations 77. Article 698

described in general terms what credits were allowed for foreign taxes, and then, in a specific example, stated that to determine the amount of the credit the ratio of dividends received to accumulated profits should be applied to the proportion of the foreign taxes which the accumulated profits bore to the total profits.¹⁴ After this regulation was promulgated Congress reenacted the same provision in the Revenue Acts of 1934, 1936, and 1938, and in the Internal Revenue Code. It is clear, therefore, that during the taxable years in question the Treasury interpretation accorded with what we have shown to be the plain meaning and purpose of section 131 (f).

Petitioner seeks to avoid the force of the regulation upon the ground that from 1921 to 1930 or 1931 the administrative interpretation was the construction for which he contends.¹⁵ But if, as we submit, the initial interpretation was erroneous as contrary to the statute, it cannot affect this case, for here no effort is made to apply the later interpretation retroactively.¹⁶ *Morrissey v. Commissioner*, 296 U. S. 344, 355; *Manhattan Co. v. Commissioner*, 297 U. S. 129. It is equally well set-

¹⁴ The example appears in Appendix A, on page 45. It is the dividends received from France.

¹⁵ The earlier interpretation was not expressed in the regulations, as is the present interpretation, but only in a form to which the regulations referred.

¹⁶ It was attempted to apply the new interpretation retroactively in the *International Milling* and *Aluminum* cases.

tled that even where there is scope for administrative interpretation, the Commissioner has ample power to change the effective rule prospectively through the exercise of his rule-making powers. *Helvering v. Wilshire Oil Co.*, 308 U. S. 90; *Helvering v. Reynolds*, 313 U. S. 428; *White v. Winchester Country Club*, No. 63, this Term, decided January 12, 1942.

In an effort to reargue these cases petitioner's brief advances six reasons in support of its conclusion that the prior interpretation is embedded in the law so that only Congress can change it. Two are that the present construction is not consistent with the statute (Br. 62, (1)) and that the prior construction was correct (Br. 63 (5)). We have shown already that those contentions are erroneous. Another reason given is that the room for administrative rule making under Section 131 (f) is narrower than under a general statutory provision (Br. 62-63 (4)). But while this might be urged as material to whether a particular regulation was authorized,¹⁷ it is obviously irrelevant to the question of the power of the Commissioner to change regulations within whatever field for interpreta-

¹⁷ Petitioner cites upon this point *Helvering v. Janney*, 311 U. S. 189; *Taft v. Helvering*, 311 U. S. 195, and *Helvering v. Oregon Mutual Life Insurance Co.*, 311 U. S. 267. These cases held that the revised regulations were invalid because contrary to unambiguous statutes. Moreover, the *Oregon Mutual* case involved an attempt to apply the revised regulation retroactively.

tion the statute allows him.¹⁸ The remaining three reasons advanced reduce to the contention that the first interpretation was contemporaneous, that it was unchanged for a decade and that no circumstances at the time of the change give peculiar weight to the new interpretation. (Br. 62-63, (2), (3), (6)). These contentions were implicitly held not to be persuasive in the above-cited cases; the earlier regulation is usually more nearly contemporaneous and the passage of time and the absence of peculiar circumstances are no reason for perpetuating an unwise or erroneous interpretation. As was pointed out in the *Wilshire* case the very essence of sound administrative practice requires a certain amount of flexibility, so that rulings shown by experience to be erroneous or unwise may be modified. See 308 U. S. at 101. Indeed, Congress itself not only recognized the power of the Treasury to change its regulations, but has gone further and has given the Treasury discretion whether to apply the modified regulations with or without retroactive effect. Section 605, Revenue Act of 1928, c. 852, 45 Stat. 791; Section 506, Revenue Act of 1934, c. 277, 48 Stat. 680.

¹⁸ Moreover, this Court has recognized that the discretion accorded to the Commission in the case of "general" regulations (as in the *Wilshire* case) is comparable to that which he enjoys in the case of ordinary regulations interpreting the various provisions of the Revenue Acts. See *Magruder v. Washington, Baltimore and Annapolis Realty Co.*, No. 661, this Term, advance sheets, pp. 3-4.

It is submitted, therefore, that the present regulation is conclusive of the case. Certainly, it is a permissible construction of the phrase "taxes paid * * * upon or with respect to the accumulated profits" to rule that it includes only that proportion of the total foreign taxes that the accumulated profits bear to the total profits upon or with respect to which the total foreign taxes were imposed.

CONCLUSION

For the reasons stated, the judgment of the Court of Claims should be affirmed.

Respectfully submitted.

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APRIL 1942.

APPENDIX A

Revenue Acts of 1936 and 1938, Section 131 provides in part:

(a) ALLOWANCE OF CREDIT.—If the taxpayer signifies in his return his desire to have the benefits of this section, the tax imposed by this title shall be credited with:

(1) CITIZEN AND DOMESTIC CORPORATIONS.—In the case of a citizen of the United States and of a domestic corporation, the amount of any income, war-profits, and excess-profits taxes paid or accrued during the taxable year to any foreign country or to any possession of the United States; and

(b) LIMIT ON CREDIT.—The amount of the credit taken under this section shall be subject to each of the following limitations:

(1) The amount of the credit in respect of the tax paid or accrued to any country shall not exceed the same proportion of the tax against which such credit is taken, which the taxpayer's net income from sources within such country bears to his entire net income for the same taxable year; and

(2) The total amount of the credit shall not exceed the same proportion of the tax against which such credit is taken, which the taxpayer's net income from sources without the United States bears to his entire net income for the same taxable year.

(f) TAXES OF FOREIGN SUBSIDIARY.—For the purposes of this section a domestic corporation which owns a majority of the voting stock of a foreign corporation from which it receives dividends in any taxable year shall be deemed to have paid the same proportion of any income, war-profits, or excess-profits taxes paid by such foreign corporation to any foreign country or to any possession of the United States, upon or with respect to the accumulated profits of such foreign corporation from which such dividends were paid, which the amount of such dividends bears to the amount of such accumulated profits: *Provided*, That the amount of tax deemed to have been paid under this subsection shall in no case exceed the same proportion of the tax against which credit is taken which the amount of such dividends bears to the amount of the entire net income of the domestic corporation in which such dividends are included. The term "accumulated profits" when used in this subsection in reference to a foreign corporation, means the amount of its gains, profits, or income in excess of the income, war-profits, and excess-profits taxes imposed upon or with respect to such profits or income; and the Commissioner with the approval of the Secretary shall have full power to determine from the accumulated profits of what year or years such dividends were paid; treating dividends paid in the first sixty days of any year as having been paid from the accumulated profits of the preceding year or years (unless to his satisfaction shown otherwise), and in other respects treating dividends as having been

paid from the most recently accumulated gains, profits, or earnings. In the case of a foreign corporation, the income, war profits, and excess-profits taxes of which are determined on the basis of an accounting period of less than one year, the word "year" as used in this subsection shall be construed to mean such accounting period.

* * * * *

Treasury Regulations 62 (1922 Edition), promulgated under the Revenue Act of 1921:

ART. 612. *Domestic corporation owning a majority of the stock of foreign corporation.*—A domestic corporation which owns a majority of the voting stock of a foreign corporation from which it receives dividends (not deductible under section 234) in any taxable year, shall be entitled to credit against the amount of its income, war profits or excess profits taxes, the same proportion of the sum of any income, war profits or excess profits taxes paid or accrued by such foreign corporation to any foreign country or to any possession of the United States, upon or with respect to the accumulated profits of such corporation from which such dividends were paid, which the amount of any such dividends received bears to the amount of such accumulated profits. But in no case shall such credit exceed the same proportion of the taxes against which it is credited, which the amount of such dividends bears to the amount of the entire net income of the domestic corporation in which such dividends are included. A domestic corporation seeking such credit must comply with those pro-

visions of subdivision (a) of article 383 which are applicable to credits for taxes already paid, except that in accordance with article 611 the form to be used is Form 1118 instead of Form 1116.

For the purposes of section 238 a corporation entitled to the benefits of section 262 is treated as a foreign corporation.

Treasury Regulations 94, promulgated under the Revenue Act of 1936:

ART. 131-7. Domestic corporation owning a majority of the stock of foreign corporation.—In the case of a domestic corporation which owns a majority of the voting stock of a foreign corporation from which it receives dividends in any taxable year, the credit for foreign taxes includes not only the income, war-profits, and excess-profits taxes paid or accrued during the taxable year to any foreign country or to any possession of the United States by such domestic corporation, but also income, war-profits, and excess-profits taxes deemed to have been paid determined by taking the same proportion of any income, war profits, and excess-profits taxes paid or accrued by such controlled foreign corporation to any foreign country or to any possession of the United States, upon or with respect to the accumulated profits of such foreign corporation from which such dividends were paid, which the amount of any such dividends received bears to the amount of such accumulated profits. The amount of taxes deemed to have been paid is limited, however, to an amount which shall in no case exceed the same proportion of the tax against which the credit for foreign taxes

is taken, which the amount of such dividends bears to the amount of the entire net income of the domestic corporation in which such dividends are included. If dividends are received from more than one controlled foreign corporation, the limitation is to be computed separately for the dividends received from each controlled foreign corporation. If the credit for foreign taxes includes taxes deemed to have been paid, the taxpayer must furnish the same information with respect to the taxes deemed to have been paid as it is required to furnish with respect to the taxes actually paid or accrued by it. Taxes paid or accrued by a controlled foreign corporation are deemed to have been paid by the domestic corporation for purposes of credit only.

ART. 131-8. Limitations on credit for foreign taxes.—The amount of the income and profits taxes paid or accrued (including the taxes which, in accordance with the provisions of section 131 (f), are deemed to have been paid) during the taxable year to each foreign country or possession of the United States, limited under section 131 (b) (1) so as not to exceed that proportion of the tax against which credit is taken which the taxpayer's net income from sources within such country or possession bears to his entire net income for the same taxable year, is the tentative credit in respect of the taxes paid or accrued to such country or possession. The sum of these tentative credits, limited under section 131 (b) (2) so as not to exceed the same proportion of the tax against which credit is taken which the taxpayer's net income from sources without the United States bears to his entire net

income for the same taxable year, is the amount allowable as a credit against the income tax under Title I for income or profits taxes paid or accrued to foreign countries or possessions of the United States.

The operation of the limitations on the credit for foreign taxes may be illustrated by the following examples:

Example (3).—The net income for the calendar year 1936 and the income and profits taxes paid or accrued to foreign countries and possessions of the United States in the case of a domestic corporation were as follows:

Country	Net income	Loss	Income and profits taxes (paid or accrued)
United States	\$200,000		
Great Britain	30,000		\$7,500
Canada	20,000		1,800
Brazil	40,000		2,400
Argentine Republic	60,000		None
Mexico		\$100,000	None
Puerto Rico	10,000		1,250
France (dividend)	50,000		9,000
France (branch)	20,000		3,000

¹ Withheld.

Entire net income	\$330,000
Total foreign net income	130,000
United States tax before allowance of credit for foreign taxes	48,340

The income and losses from all foreign countries and possessions of the United States, except the dividend from sources within France, were derived from branch operations. Dividends of \$50,000 were received from a French corporation, a majority of the voting stock of which was

owned by the domestic corporation. The French corporation paid to France income and profits taxes on income earned by it and in addition a dividend tax for the account of its shareholders on income distributed to them, the latter tax being withheld and paid at the source.

The computation of the credit is as follows:

GREAT BRITAIN

Income and profits taxes paid or accrued	\$7,500.00
Limitation under section 131 (b) (1)	
$\left(\frac{30,000}{330,000} \text{ of } \$48,340 \right)$	4,303.55
Tentative credit	4,303.55

CANADA

Income and profits taxes paid or accrued	\$1,800.00
Limitation under section 131 (b) (1)	
$\left(\frac{20,000}{330,000} \text{ of } \$48,340 \right)$	2,929.70
Tentative credit	1,800.00

BRAZIL

Income and profits taxes paid or accrued	\$2,400.00
Limitation under section 131 (b) (1)	
$\left(\frac{40,000}{330,000} \text{ of } \$48,340 \right)$	5,850.40
Tentative credit	2,400.00

ARGENTINE REPUBLIC

Tentative credit	None
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MEXICO

Tentative credit	None
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PUERTO RICO

Income and profits taxes paid or accrued	\$1,250.00
Limitation under section 131(b)(1)	
$\left(\frac{10,000}{330,000} \text{ of } \$48,340 \right)$	1,464.85
Tentative credit	1,250.00

FRANCE

Dividend tax paid at source	9,000.00
Income and profits taxes paid or accrued on branch operations	3,000.00
Income and profits taxes deemed under section 131(f) to have been paid, computed as follows:	
Dividend received on December 31 of the taxable year	\$50,000.00
Income of French corporation earned during taxable year	200,000.00
Income and profits taxes paid to France on \$200,000	30,000.00
Accumulated profits (\$200,000 minus \$30,000)	170,000.00
French taxes applicable to accumulated profits distributed	
$\left(\frac{50,000}{170,000} \text{ of } \left(\frac{170,000}{200,000} \text{ of } \$30,000 \right) \right)$	7,500.00
Limitation under section 131(f)	
$\left(\frac{50,000}{330,000} \text{ of } \$48,340 \right)$	7,324.24
Income and profits taxes deemed to have been paid (French taxes applicable to accumulated profits distributed to domestic corporation, reduced in accordance with the limitation under section 131(f))	7,324.24
Total income and profits taxes paid or accrued and deemed to have been paid to France	19,324.24
Limitation under section 131(b)(1)	
$\left(\frac{70,000}{330,000} \text{ of } \$48,340 \right)$	10,253.94
Tentative credit	10,253.94

SUM OF TENTATIVE CREDITS

Great Britain	\$4,394.25
Canada	1,800.00
Brazil	2,400.00
Puerto Rico	1,250.00
France	10,253.94

Limitation on sum of tentative credits under section 131(b)(2) to determine credit	20,098.19
$\left(\frac{130,000}{330,000} \text{ of } \$48,340 \right)$	19,043.03
Total amount of credit allowable (sum of tentative credits reduced in accordance with the limitation under section 131(b)(2))	19,043.03

APPENDIX B

The Court of Claims in *International Milling Co. v. Commissioner*, 89 C. Cls. 128, and the Circuit Court of Appeals for the Third Circuit in *Aluminum Company of America v. United States*, 123 F. (2d) 615, decided the question here involved adversely to the Commissioner partly upon the ground that the Commissioner ignored the words "accumulated profits" in Section 131 (f) and thereby reduced the formula prescribed by the section to the formula of Section 238 (e) of the Revenue Act of 1918. We have shown in our argument why this view is erroneous. To establish the concrete differences we give below some examples of the operation of (a) Section 240 (e) of the Revenue Act of 1918, (b) Section 131 (f), as applied by the Commissioner, and (c) Section 131 (f) if applied according to petitioner's interpretation. In all the examples a Canadian subsidiary 80% of whose stock is owned by a domestic corporation earns profits and pays foreign income, war-profits, and excess-profits taxes as follows:

Year	Total Profits	Foreign Taxes	Date Taxes Paid
1918	\$400,000	60,000	Mar. 1, 1919
1919	300,000	60,000	Mar. 1, 1920
1920	300,000	60,000	Mar. 1, 1921
1921	deficit	none	

Example 1.—Assume that in 1922 the subsidiary distributes to the parent (which owns 80% of the stock) a dividend of \$120,000.

(a) The formula of the 1918 Act is:

$$\text{Credit} = \frac{\text{Dividends received}}{\text{Profits upon which taxes paid in taxable year were paid}} \times \text{Taxes paid in taxable year}$$

Since no foreign taxes were paid in the taxable year 1922, there is no credit. The \$120,000 is subjected to double taxes—to the Canadian taxes when earned and to the United States taxes when received as a dividend.

(b) The formula of Section 131 (f) as applied by the Commissioner is:

$$\text{Credit} = \frac{\text{Dividends received}}{\text{Accumulated profits from which dividends were paid}} \times \frac{\text{Total profits in year in which were accumulated the profits from which dividends were paid}}{\text{Taxes upon such total profits}}$$

Under the Act the dividends are deemed to be paid from the most recently accumulated profits, which would be those of 1920. The accumulated profits, therefore, would be calculated as Section 131 (f) prescribes:

$$\$200,000 - \$50,000 = \$150,000$$

Substituting in the formula:

$$\text{Credit} = \frac{\$120,000}{\$150,000} \times \left(\frac{\$150,000}{\$200,000} \times \$50,000 \right)$$

$$\text{Credit} = \frac{\$120,000}{\$200,000} \times \$50,000$$

$$\text{Credit} = \$30,000$$

The result is that the parent received 60% of the subsidiary's total 1920 earnings and was treated as if it paid 60% of its total 1920 taxes.

(c) Petitioner's formula is:

$$\text{Credit} = \frac{\text{Dividends received}}{\text{Accumulated profits}} \times$$

Total taxes
upon total
profits in year
in which were
accumulated
the profits
from which the
dividend was
paid.

Substituting the proper figures:

$$\text{Credit} = \frac{\$120,000}{\$150,000} \times \$50,000$$

$$\text{Credit} = \$40,000$$

The result would be that the parent which received 60% of the subsidiary's total 1920 earnings would be treated as if it had paid 80% of the subsidiary's total 1920 taxes.

Example 2.—Assume that the parent (owning 80% of the stock) received a dividend of \$80,000 (out of a total dividend of \$100,000) on December 31, 1920.

(a) Applying the formula of the 1918 Act (set out in Example 1 (a)), the calculation would be

$$\text{Credit} = \frac{\$80,000}{\$300,000} \times \$60,000$$

$$\text{Credit} = \$16,000$$

Because the ratio is applied to the taxes paid during the taxable year 1920 on 1919 income, and not to the taxes upon the accumulated earnings of 1920 from which the dividend was paid, the parent which receives 40% of the subsidiary's total 1920 profits receives a credit equal to 32% of its total 1920 taxes.

(b) Substituting in the Commissioner's formula under Section 131 (f) (set out in Example 1 (b)), the accumulated profits from which the dividend was paid would be:

$$\$200,000 - \$50,000 = \$150,000$$

and the calculation:

$$\text{Credit} = \frac{\$80,000}{\$150,000} \times \left(\frac{\$150,000}{\$200,000} \times \$50,000 \right)$$

$$\text{Credit} = \$20,000$$

The parent which received 40% of the subsidiary's total 1920 profits would receive a credit equal to 40% of its total 1920 taxes.

(c) Substituting in the petitioner's formula, the calculation would be:

$$\text{Credit} = \frac{\$80,000}{\$150,000} \times \$50,000$$

$$\text{Credit} = \$26,666.67$$

Thus, the parent which received 40% of the subsidiary's total 1920 profits would receive a credit of more than 50% of its total 1920 taxes.

Example 3.—Assume that on June 30, 1920, the parent (owning 80% of the stock) received a dividend of \$160,000 (of a total dividend of \$200,000). Assume further that \$100,000 of the 1920 earnings of \$200,000 were earned in the first six months of 1920.

(a) The calculation under the 1918 Act would be

$$\text{Credit} = \frac{\$160,000 \text{ (dividend)}}{\$300,000 \text{ (taxable income on which taxes were paid in taxable year)}} \times \$60,000 \text{ (taxes paid in taxable year 1920)}$$

$$\text{Credit} = \$32,000$$

(b) Applying Section 131 (f) it is apparent that, as both Commissioner and petitioner read it, the relevant accumulated profits would be, first, \$100,000 from 1920 less \$25,000 taxes upon it = \$75,000 and, second, \$300,000 from 1919 less \$60,000 taxes upon it = \$240,000. The Commissioner would make two calculations:

$$(1) \text{ Credit} = \frac{\$60,000^1}{\$75,000} \times \left(\frac{\$75,000}{\$100,000} \times \$25,000 \right)$$

$$\text{Credit} = \$15,000$$

$$(2) \text{ Credit} = \frac{\$100,000}{\$240,000} \times \left(\frac{\$240,000}{\$300,000} \times \$60,000 \right)$$

$$\text{Credit} = \$20,000$$

¹ The portion of the parent's total dividend which was paid from 1920 profits.

The total credit is \$35,000.

(c) Petitioner would calculate:

$$(1) \text{ Credit} = \frac{\$60,000}{\$75,000} \times \$25,000$$

$$\text{Credit} = \$20,000$$

$$(2) \text{ Credit} = \frac{\$100,000}{\$240,000} \times \$60,000$$

$$\text{Credit} = \$25,000$$

The total credit would be \$45,000.

Example 4.—Assume that on January 1, 1920, the parent received a dividend of \$80,000.

(a) The computation under the 1918 Act would be:

$$\text{Credit} = \frac{\$80,000}{\$300,000} \times \$60,000$$

$$\text{Credit} = \$16,000.$$

(b) The Commissioner's computation under Section 131 (f) would use as the source of the dividend the accumulated earnings from 1919, which were \$240,000. The computation would be:

$$\text{Credit} = \frac{\$80,000}{\$240,000} \times \left(\frac{\$240,000}{\$300,000} \times \$60,000 \right)$$

$$\text{Credit} = \$16,000.$$

Here for the first time the formula of the 1918 Act and the formula used by the Commissioner under Section 131 (f) led to equal credits. The reason is that the total taxes paid in the taxable year in this example were the total taxes imposed upon the taxable income out of which the dividend was distributed. It is only in such a case, *i. e.*,

when a distribution is made out of the earnings of the preceding year and out of them alone that the two formulae lead to allowing the same credit.

(c) As in the other examples petitioner's formula would allow an overcredit.

Example 5.—Assume dividends are received by the parent (owning 80% of the stock) on January 1, 1920, amounting to \$400,000 (out of a total dividend of \$500,000).

(a) The computation under the 1918 Act would not be

$$\text{Credit} = \frac{\$400,000}{\$200,000} \times \$60,000$$

for under the 1918 Act the total taxes paid in the taxable year was the maximum allowable credit.

(b) Under Section 131 (f) the dividend would have its source in the \$240,000 accumulated profits of 1919 and in the \$340,000 accumulated profits of 1918. The two computations would be:

$$(1) \text{ Credit} = \frac{\$192,000}{\$240,000} \times (\frac{\$240,000}{\$300,000} \times \$60,000)$$

$$\text{Credit} = \$38,400$$

$$(2) \text{ Credit} = \frac{\$208,000}{\$340,000} \times (\frac{\$340,000}{\$400,000} \times \$60,000)$$

$$\text{Credit} = \$31,200$$

Therefore the total credit would be \$69,600.

(c) Petitioner's formula would again allow an overcredit.

² The portion of the parent's total dividend which was paid from the 1919 profits.



SUPREME COURT OF THE UNITED STATES.

No. 913.—OCTOBER TERM, 1941.

American Chicle Company, Petitioner,
vs.
The United States. } On Writ of Certiorari to
 } the Court of Claims.

[June 1, 1942.]

Mr. Justice ROBERTS delivered the opinion of the Court.

This case involves the application of Section 131(f) of the Revenue Acts of 1936 and 1938¹ which allows a tax credit to domestic corporations in respect of income received from foreign subsidiaries.

During the taxable years 1936, 1937, and 1938, the petitioner, a domestic corporation, received dividends from foreign subsidiaries of which it was sole stockholder. The subsidiaries paid taxes upon their earnings to the countries of their domicile. In its income tax returns the petitioner claimed the credit allowed by § 131 for the foreign taxes so paid. The Commissioner of Internal Revenue computed the credit at a less sum than that the petitioner claimed. The petitioner paid the resultant taxes and presented claims for refund, which were rejected. This action was brought in the Court of Claims for asserted overpayments.

The sole matter in controversy is the proper method of arriving at the credit granted by § 131. That section permits a domestic corporation to credit against its tax the amount of income, war-profits, and excess-profits taxes paid or accrued during the taxable year to any foreign country, with certain limits set by subsections (b) (1) and (2). The purpose of the provision, like that of its predecessor, § 238 of the Revenue Act of 1921,² is to obviate double taxation.³

Section 131(f), dealing with taxes of a foreign subsidiary,⁴ provides that, for the purpose of the section, a domestic corporation receiving dividends from such a subsidiary "in any taxable

¹ 49 Stat. 1648, 1696; 52 Stat. 447, 506; 26 U. S. C. § 131.

² 42 Stat. 227, 258.

³ *Burnet v. Chicago Portrait Co.*, 285 U. S. 1.

⁴ A foreign corporation of whose voting stock the taxpayer owns a majority.

year shall be deemed to have paid the same proportion of any income, war-profits, or excess-profits taxes paid" by the subsidiary to a foreign country. "upon or with respect to the accumulated profits" of the subsidiary "from which such dividends were paid, which the amount of such dividends bears to the amount of such accumulated profits." "Accumulated profits" of the subsidiary are defined as "the amount of its gains, profits, or income in excess of the income, war-profits, and excess-profits taxes imposed upon or with respect to such profits or income."

The parties are in agreement as to the fraction to be used in calculating the proportion. The numerator is the dividends received by the parent. The denominator is the "accumulated profits" of the subsidiary. The dispute relates to the multiplicand to which the fraction is to be applied. The petitioner says it is the total foreign taxes paid by the subsidiary. The respondent says it is the taxes paid upon or with respect to the accumulated profits of the subsidiary; i. e., so much of the taxes as is properly attributed to the accumulated profits, or the same proportion of the total taxes which the accumulated profits bear to the total profits. The Court of Claims so held.⁵ Since several decisions have gone the other way,⁶ we granted certiorari.

If the language of the Revenue Act is to be given effect, the Government's view seems correct. The statute does not purport to allow a credit for a stated proportion of the total foreign taxes paid or the foreign taxes paid "upon or with respect to" total foreign profits, but for taxes paid "upon or with respect to" the subsidiary's "accumulated profits", which, by definition, are its total taxable profits less taxes paid.

If, as is admitted, the purpose is to avoid double taxation, the statute, as written, accomplishes that result. The parent receives dividends. Such dividends, not its subsidiary's profits, constitute its income to be returned for taxation. The subsidiary pays tax on, or in respect of, its entire profits; but, since the parent receives distributions out of what is left after payment of the foreign tax,—that is, out of what the statute calls "accumulated profits", it should receive a credit only for so much of the foreign tax paid as relates to or, as the Act says, is paid upon, or with respect to, the accumulated profits.

⁵ 41 F. Supp. 537.

⁶ F. W. Woolworth Co. v. United States, 91 F. 2d 973; International Milling Co. v. United States, 89 C. Cls. 128, 27 F. Supp. 592; Aluminum Co. of America v. United States, 123 F. 2d 615.

Hence we think that, under the plain terms of the Act, the Commissioner and the court below were right in limiting the credit by the use as multiplicand of a proportion of the tax paid abroad appropriately reflecting the relation of accumulated profits to total profits of the subsidiary. But the petitioner insists that the legislative history and a long indulged administrative construction require us, in effect, to elide the phrase "upon or with respect to the accumulated profits" of the foreign subsidiary.

Section 240(e) of the Revenue Act of 1918⁷ allowed the domestic parent receiving dividends from a foreign subsidiary a credit for the same proportion of the taxes paid by the foreign corporation during the taxable year to any foreign country which the amount of the dividends received by the parent during the taxable year bore to the total taxable income of the subsidiary upon or with respect to which such taxes were paid.

This provision had the same object as § 131 of the Revenue Acts of 1936 and 1938; that is, to avoid double taxation. The difficulty with it was that it did not relate the credit to the accumulated profits or surplus of the subsidiary out of which the dividends were paid. Thus, if dividends were paid out of surplus earned in prior years, and it happened that the subsidiary paid no tax to the foreign country in the taxable year in question, the parent could claim no credit whatever. There were other eccentric results flowing from the provision of the Act of 1918.

In the Revenue Act of 1921 § 238(e)⁸ was the analogous section. The draftsman of the section stated to the Senate Committee in charge of the measure: "I rewrote the old provision, safeguarding it from some abuses which it was open to and closing up some of the gaps that were in the old provision." Section 238(e) is substantially the same as § 131(f). The alterations of § 240(e) of the Act of 1918 were made to permit identification of the accumulated profits of each taxable year out of which the dividends might have been paid and to give credit for a proportion of the subsidiary's taxes attributable to such accumulated profits.

The Chairman of the Senate Finance Committee indicated that the calculation of the proportion of foreign tax paid would be exactly the same as it had been under the 1918 Act. But this would be true only if the dividends were paid in a given year

⁷e. 18, 40 Stat. 1057, 1082.

⁸e. 136, 42 Stat. 227, 259.

out of the prior year's earnings and taxes were paid in the same year in respect of the same prior year's earnings. The petitioner seeks in this case to apply the proportion provided by the 1918 Act; but this is to ignore the alterations made in that Act in 1921 which have ever since been retained. In Committee hearings and in Congressional Reports with respect to the purpose and effect of the changes wrought by the 1921 Act there were statements indicating an understanding that the credit was to be proportioned to the dividends made available to the parent in this country.

The Treasury made no regulation applicable to § 238(e) of the Revenue Act of 1921. It provided a form for reporting the tax, which sanctioned the petitioner's method of computing the credit; and, from 1921 to 1930, the Commissioner calculated credits for foreign subsidiaries' taxes by that method. In 1930, however, the Treasury promulgated a new form which required the credit to be computed in the way the Commissioner did in the present case; and promulgated Regulations 77 under the Revenue Act of 1932, which, in Article 698, required the computation of the credit in the same manner. The regulations have since remained unchanged. See Regulations 103 §§ 19.131-3 and 19.131-8. Although the regulations definitely govern this case, and were made prior to the years in controversy, the petitioner insists that the antecedent administrative interpretation long in force renders it impossible for the Commissioner to promulgate a regulation changing for the future the earlier practice, even though the new regulation comports with the plain meaning of the statute. We think the contention cannot be sustained⁹.

The judgment is

Affirmed.

⁹ Helvering v. Wilshire Oil Co., 308 U. S. 90; Helvering v. Reynolds, 313 U. S. 428; White v. Winchester Country Club, No. 63, October Term, 1941.

A true copy.

Test:

Clerk, Supreme Court, U. S.